FRBSF Weekly Letter

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California Banks Playing Catch-up

Banking conditions in California improved last year. Bank earnings, asset quality, and capital positions were all up compared to 1992. Nevertheless, the effects of the prolonged recession in California on banking were evident, as the banking industry in the state lagged well behind the very strong performance turned in by banks nationally in 1993. Moreover, there was considerable disparity in performance among banks. The very largest banks in the state accounted for most of the overall improvement, while smaller banks with activities concentrated in regions like Southern California that were hit hardest by the recession continued to show sizable losses.

The economy

California has been a tough environment for most banks. During the three and one-half year recession, the severest slump since the 1940s, payroll employment in California dropped by 614,000, or about 4.9 percent, from its peak level in July 1990 to its low point in December of last year.

The cutbacks in the aerospace and defense industries were a big part of the problem. Declines in residential and commercial real estate construction and values also have been a drag on the state's economy.

The economic climate in the state, however, is improving. In recent months, state tax revenues have leveled off, following the sharp drops seen earlier in the recession, and retail sales also have stabilized. In real estate, home sales have picked up, and office vacancy rates have improved. More concretely, payroll employment increased 42,900 in the first quarter of 1994.

Banking conditions improve . . .

Despite the weak economy, banking conditions in the state improved in 1993. Return on assets (ROA), for example, was 0.86 percent for all of 1993, up from 0.57 percent in 1992. A good deal of the improvement was due to strong performances by the three largest banks in the state, which had a combined ROA for all of 1993 of 1.18 percent, up from 0.79 percent in 1992. For the other banks as a group, the increase in average ROA was a much more modest 5 basis points. One difference for the largest banks was a smaller decline in the yield on earning assets.

A sign of improvement for California banks more generally was the drop in provisions against loan losses. By itself, the decline in this expense last year added over 30 basis points to the average ROA for banks in the state. The decline may reflect some easing of the recession in California last year. Also important, though, were some banks' aggressive efforts to build up reserves against problem loans in the two previous years. Another factor affecting asset quality, and therefore the need for loan loss expenses, was more cautious lending by banks. Commercial banks in California tightened credit standards and sharply contracted loans in recent years.

. . . but lag the U.S.

The prolonged recession in California, however, had an effect. Overall earnings in the state, for example, lagged well behind the record 1.21 percent ROA for banks nationally. The lingering effects of the recession on banking in California are even more apparent when comparing the percentages of banks losing money. Figure 1 shows that the percentage of banks in the nation reporting net losses decreased steadily over the past few years. By contrast, in California the share of banks reporting losses doubled over the same time period.

Improvements in asset quality among California banks also have lagged. Figure 2 shows that the problem loan ratio for banks nationally rose during the national recession—mid-1990 to the first quarter of 1991. For all of California, the ratio continued to rise for another year going well above the figure for the nation. Despite impressive declines, aided last year by bulk sales by

WESTERN BANKING *Western Banking* is a quarterly review of banking developments in the Twelfth Federal Reserve District. It is published in the *Weekly Letter* on the fourth Friday of January, April, July, and October.

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Figure 1
Percentage of Banks with Negative Net Income

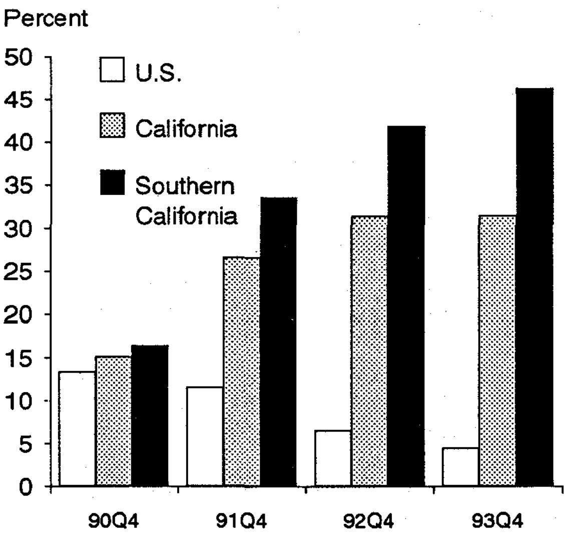
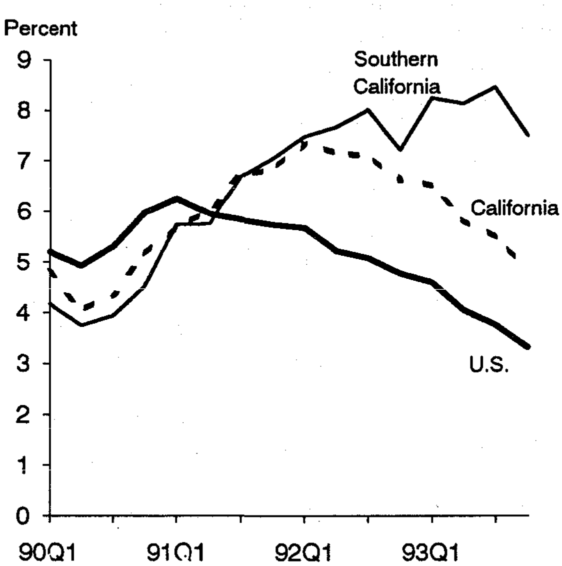


Figure 2
Total Problem Loan Ratios



some of the state's largest banks, the aggregate problem loan ratio for banks in California still is noticeably higher than for the U.S., suggesting the need for further reductions in problem loans by banks in the state.

The aggregate capital position of California banks has kept up better with the national trend, though even here there are some signs of a lag. Using risk-based capital standards, banks can be categorized well, adequately or under-capitalized. In the last quarter of 1993, 98 percent of banks in the U.S. were considered to be well-capitalized, but only 86 percent of California banks met this standard.

Disparities within California

The recession has been very uneven within the state. By far the hardest hit area has been Southern California, where payroll employment dropped by as much as 7.5 percent during the recession. In the greater San Francisco Bay Area, payroll employment fell by close to 3.5 percent. The Central Valley, where the economic downturn was shorter and shallower, managed a net increase in payroll employment during the statewide recession.

The disparities in economic conditions are mirrored by the performance of commercial banks operating in these regions. Community banks (assets less than $300 million) in Southern California showed even larger losses than last year—ROA in 1993 was −0.63 percent, compared with −0.44 percent in 1992—with a little less than half the banks in the region losing money at the end of last year. In the other regions of California, earnings among community banks were positive in 1993, with the average ROA higher for community banks in the Central Valley than for those in Northern California.

In Southern California, the losses have impeded improvements in capital positions at many banks. Though most community banks in the region meet minimum capital standards, only 78 percent were well-capitalized at the end of last year. The deterioration in economic conditions in Southern California also is reflected in bank asset quality. Figure 2 shows that the problem loan ratio for community banks in Southern California continued to rise after it peaked in California as a whole.

Conclusion

Banking conditions in California have improved, though the state's prolonged economic slump had an impact on many banks in the state. A large number of the banks in the state still were losing money last year and needed further improvement in asset quality, particularly among those with activities concentrated in Southern California. With signs of life in the state's economy, including Southern California, however, most banks should have room to work through the hangover from the recession.

Fred Furlong
Vice President,
Banking & Regional Studies

Jennifer Soller
Research Associate,
Banking & Regional Studies

REGIONAL BANK DATA

DECEMBER 31, 1993
(NOT SEASONALLY ADJUSTED, PRELIMINARY DATA)

		DISTRICT	ALASKA	ARIZ.	CALIF.	HAWAII	IDAHO	NEVADA	OREGON	UTAH	WASH.
ASSETS AND LIABILITIES – $ MILLION (ALL COMMERCIAL BANKS)											
ASSETS	TOTAL	505,577	4,979	37,104	328,070	22,261	10,941	17,999	27,388	15,399	41,435
	FOREIGN	33,895	0	0	31,910	1,909	0	0	34	0	41
	DOMESTIC	471,682	4,979	37,104	296,160	20,351	10,941	17,999	27,355	15,399	41,394
LOANS	TOTAL	335,696	2,646	21,563	219,967	14,058	7,818	10,470	19,056	9,178	30,940
	FOREIGN	29,891	5	0	28,539	1,301	0	0	6	0	39
	DOMESTIC	305,806	2,641	21,563	191,427	12,757	7,818	10,470	19,050	9,178	30,901
	REAL ESTATE	160,169	1,328	8,171	112,318	7,681	2,535	2,526	7,967	4,115	13,526
	COMMERCIAL	61,210	763	2,712	37,670	3,133	1,576	779	4,986	1,600	7,991
	CONSUMER	55,910	406	7,152	24,009	1,096	2,405	6,758	4,032	2,784	7,267
	AGRICULTURAL	6,096	3	373	3,166	32	824	14	510	158	997
	OTHER	22,420	141	3,156	14,245	815	478	393	1,554	521	1,116
SECURITIES	TOTAL	84,009	1,846	10,354	48,328	5,308	1,815	4,311	4,333	3,375	4,339
	U.S. TREASURIES	26,430	944	2,584	14,584	2,710	462	1,566	1,452	697	1,430
	U.S. AGENCIES	42,625	467	6,204	25,992	2,087	687	2,233	2,048	1,620	1,289
	OTHER SEC.	14,954	435	1,566	7,752	511	667	512	833	1,058	1,619
LIABILITIES	TOTAL	461,197	4,314	33,739	300,206	20,476	10,110	15,688	25,004	14,069	37,591
	DOMESTIC	427,302	4,314	33,739	268,296	18,566	10,110	15,688	24,970	14,069	37,550
DEPOSITS	TOTAL	400,101	3,781	29,703	266,614	14,320	8,338	10,245	21,418	11,205	34,477
	FOREIGN	29,948	0	0	28,017	1,744	0	0	34	75	79
	DOMESTIC	370,153	3,781	29,703	238,598	12,576	8,338	10,245	21,384	11,130	34,398
	DEMAND	98,108	1,163	6,876	66,135	2,653	1,701	3,172	4,963	2,660	8,787
	NOW	43,230	386	3,617	25,289	1,539	1,098	1,449	3,448	1,623	4,781
	MMDA & SAVINGS	140,463	1,305	11,022	93,283	4,957	2,825	3,905	6,860	3,710	12,595
	SMALL TIME	61,511	436	6,833	35,155	1,955	2,081	937	5,214	2,449	6,450
	LARGE TIME	26,508	449	1,354	18,538	1,462	631	783	881	684	1,726
	OTHER	333	43	0	197	9	2	0	17	4	59
OTHER BORROWINGS		37,658	496	3,327	14,827	5,454	1,605	4,254	2,937	2,601	2,157
EQUITY CAPITAL		44,379	665	3,365	27,863	1,785	831	2,311	2,384	1,331	3,844
LOAN LOSS RESERVE		9,789	38	469	7,202	231	116	486	436	207	605
LOAN COMMITMENTS		210,840	736	32,062	111,946	7,157	3,097	16,599	14,113	7,306	17,823
LOANS SOLD		19,879	26	233	18,292	159	46	205	129	115	674
TIER1 CAPITAL RATIO		0.100	0.214	0.122	0.093	0.107	0.097	0.153	0.101	0.129	0.093
TOTAL CAPITAL RATIO		0.129	0.225	0.144	0.127	0.127	0.116	0.166	0.118	0.146	0.116
LEVERAGE RATIO		0.079	0.128	0.080	0.076	0.075	0.074	0.118	0.081	0.084	0.082
EARNINGS AND RETURNS -- $ MILLION (ALL COMMERCIAL BANKS)											
INCOME	TOTAL	11,177	108	767	6,919	431	228	761	670	359	934
	INTEREST	8,302	88	614	5,177	361	192	383	476	277	734
	FEES & CHARGES	760	6	61	502	13	16	16	49	22	76
EXPENSES	TOTAL	8,955	83	615	5,818	334	173	451	514	285	681
	INTEREST	2,552	25	198	1,589	137	68	87	143	96	209
	SALARIES	2,336	26	173	1,514	88	34	92	153	67	189
	LOAN LOSS PROVISION	782	6	24	613	16	6	69	23	5	20
	OTHER	3,284	27	221	2,102	92	65	202	196	117	263
TAXES		868	7	52	476	36	20	109	58	25	86
NET INCOME		1,359	17	100	623	61	35	204	102	50	167
ROA (% ANNUALIZED)		1.09	1.34	1.12	0.76	1.09	1.30	4.76	1.51	1.27	1.63
ROE (% ANNUALIZED)		12.25	10.29	11.90	8.95	13.60	17.06	35.23	17.05	14.95	17.40
NET INTEREST MARGIN (% ANNUALIZED)		4.59	4.98	4.64	4.40	4.02	4.57	6.91	4.95	4.62	5.11
ASSET QUALITY – PERCENT OF LOANS (LARGE COMMERCIAL BANKS)											
LOAN LOSS RESERVE		3.00	1.32	2.15	3.38	1.64	1.45	4.78	2.37	2.20	2.05
NET CHARGEOFFS, TOTAL		0.95	1.93	1.20	1.05	0.25	0.17	2.84	0.46	-0.02	0.40
	REAL ESTATE	0.81	-0.03	1.56	1.02	0.08	0.19	0.31	-0.02	-0.26	0.11
	COMMERCIAL	0.57	6.11	-0.50	0.68	0.35	-0.57	-0.55	0.50	0.01	0.21
	CONSUMER	2.61	0.76	1.91	3.55	1.09	0.77	4.17	1.18	0.48	1.05
	AGRICULTURAL	0.36	0.00	0.07	0.17	1.31	0.01	0.00	0.07	1.47	1.41
PAST DUE & NON-ACCRUAL, TOTAL		3.96	1.95	2.36	4.79	2.44	1.31	4.91	1.74	1.55	2.39
	REAL ESTATE	5.55	1.73	2.72	6.81	2.39	1.34	4.54	2.20	1.51	3.15
	CONSTRUCTION	19.72	4.22	3.08	26.36	7.75	2.36	20.23	10.99	3.17	11.05
	COMMERCIAL	7.56	1.62	7.42	9.78	1.44	1.29	3.99	2.87	1.95	2.56
	FARM	7.12	0.00	11.62	7.30	7.60	8.02	0.00	6.81	16.92	3.18
	HOME EQUITY LINES	1.31	0.59	0.72	1.41	1.61	0.40	0.71	0.47	0.54	1.74
	MORTGAGES	3.06	1.70	1.72	3.66	2.52	1.21	3.29	0.98	0.99	1.30
	MULTI-FAMILY	4.96	1.42	0.98	6.34	1.37	2.82	0.67	0.55	0.06	2.86
	COMMERCIAL	3.04	2.21	2.99	3.46	2.92	1.19	5.32	1.21	1.82	1.85
	CONSUMER	2.82	2.23	2.67	3.09	2.49	1.34	5.24	1.28	1.47	1.48
	AGRICULTURAL	2.38	0.00	1.99	1.59	25.50	1.70	0.39	2.73	3.74	4.69
NUMBER OF BANKS		706	8	37	422	17	21	21	45	48	87
NUMBER OF EMPLOYEES		244,262	2,806	20,022	154,242	8,740	4,827	7,891	16,730	7,865	21,139

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INTEREST RATES ON DEPOSITS AND LOANS

TYPE OF RETAIL DEPOSIT ACCOUNT OR LOAN		FEB 1992	MAY 1992	AUG 1992	NOV 1992	FEB 1993	MAY 1993	AUG 1993	NOV 1993	FEB 1994
SAVINGS ACCOUNTS AND MMDAS	U.S	3.78	3.57	3.14	2.90	2.80	2.65	2.55	2.48	2.43
	DISTRICT	3.81	3.67	3.29	3.05	2.96	2.78	2.67	2.58	2.56
92 TO 182 DAYS CERTIFICATES	U.S	4.00	3.82	3.36	3.14	3.08	2.98	2.96	2.92	2.93
	DISTRICT	3.85	3.76	3.34	3.14	3.01	2.88	2.85	2.81	2.83
2-1/2 YEARS AND OVER CERTIFICATES	U.S	5.36	5.45	4.87	4.70	4.59	4.45	4.40	4.28	4.35
	DISTRICT	5.03	5.17	4.75	4.49	4.41	4.27	4.19	4.09	4.13
COMMERCIAL SHORT TERM FIXED*	U.S	5.18	4.87	4.42	4.17	4.16	3.91	4.02	3.95	4.03
	DISTRICT	6.50	6.26	4.86	5.35	5.21	4.84	4.78	5.53	5.60
COMMERCIAL SHORT TERM FLOATING*	U.S	6.47	6.56	5.95	5.91	5.85	5.58	5.53	5.56	5.49
	DISTRICT	7.66	7.34	8.37	7.23	8.26	8.09	8.54	8.02	8.01
COMMERCIAL LONG TERM FIXED*	U.S	6.33	7.27	6.28	5.97	6.43	6.02	6.21	5.38	5.41
	DISTRICT	7.70	8.68	8.28	6.44	9.19	10.86	8.05	6.62	6.58
COMMERCIAL LONG TERM FLOATING*	U.S	6.95	7.06	6.60	6.53	6.38	6.47	6.05	5.70	5.98
	DISTRICT	8.10	7.38	7.63	8.11	8.43	8.55	8.77	7.68	8.16
CONSUMER, AUTOMOBILE	U.S	9.89	9.52	9.15	8.60	8.57	8.17	7.98	7.63	7.54
	DISTRICT	9.90	9.67	9.39	8.76	8.98	8.23	8.09	7.70	7.68
CONSUMER, PERSONAL	U.S	14.39	14.28	13.94	13.55	13.57	12.00	13.45	13.22	12.89
	DISTRICT	13.64	13.80	13.68	12.83	12.67	13.87	12.69	13.00	12.02
CONSUMER, CREDIT CARD	U.S	18.09	17.97	17.66	17.38	17.26	17.15	16.59	16.30	16.06
	DISTRICT	18.51	18.52	18.46	18.29	17.76	17.60	17.58	17.00	17.17

SOURCES: MONTHLY SURVEY OF SELECTED DEPOSITS, SURVEY OF TERMS OF BANK LENDING, AND TERMS OF CONSUMER CREDIT
MOST COMMON INTEREST RATES ON RETAIL DEPOSITS, WEIGHTED AVERAGE INTEREST RATE ON LOANS
* DATA ARE COMPOUNDED ANNUAL RATES

MARKET SHARE STATISTICS

DEPOSITORY INSTITUTIONS REQUIRED TO HOLD RESERVES WITH THE FEDERAL RESERVE ON A WEEKLY BASIS

PERCENT OF COMBINED MARKET TOTAL FOR FEBRUARY 1994, BY REGION

	DISTRICT			ALASKA			ARIZONA			CALIF			HAWAII		
DEPOSIT TYPE	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU
TOTAL DEPOSITS	55	37	7	71	4	26	91	1	8	49	45	7	64	29	8
DEMAND	89	7	4	98	0	2	96	0	4	88	8	4	91	4	5
NOW	64	27	8	60	6	34	88	0	12	58	35	7	65	31	4
SAVINGS & MMDAS	61	29	10	55	4	40	89	0	11	57	35	8	56	33	11
SMALL TIME	31	65	4	75	7	18	94	1	5	22	74	4	53	44	3
LARGE TIME	43	46	11	95	1	4	91	1	8	35	53	12	72	18	10

	IDAHO			NEVADA			OREGON			UTAH			WASH		
DEPOSIT TYPE	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU
TOTAL DEPOSITS	91	5	4	77	18	5	81	9	10	79	5	16	56	33	10
DEMAND	96	0	4	98	2	0	95	1	4	90	4	6	87	11	2
NOW	90	4	7	78	14	8	84	7	9	83	2	16	66	22	12
SAVINGS & MMDAS	91	3	5	76	15	9	76	9	14	73	3	24	56	26	18
SMALL TIME	87	10	2	46	50	5	77	16	7	80	11	9	38	56	5
LARGE TIME	90	5	4	86	14	0	78	9	12	66	14	20	44	54	2

CB = COMMERCIAL BANKS; SL = SAVINGS & LOANS AND SAVING BANKS; CU = CREDIT UNIONS; MAY NOT SUM TO 100% DUE TO ROUNDING